

Rolta India

Q1FY10/ Estimate change

26 October 2009

Sell

Target Price: Rs158

CMP: Rs194*

Downside: 18.5%

*as on 23 October 2009

Not convinced yet ...

Rolta India would have missed our PAT estimate but for the higher-than-expected other income (Rs99mn vs our estimate of Rs28mn), which we believe is a one off. Moreover, we believe there is a disconnect between high growth expectations without a commensurate change in operational stance. We would watch for reasonable evidence of operational uptick before we upgrade the stock. Maintain Sell.

- **Wary of high growth expectations:** We are wary of high growth expectations without a commensurate operational stance. Rolta expects to register robust 12%-15% revenue growth in FY10 (implying 6%-8% QoQ growth) with negligible increase in headcount (~25-30 QoQ), while utilization is close to peaks. The company does not see benefits from pricing increases nor does it see itself sub-contracting more work.
- **Higher product sales argument fails to convince:** Rolta currently derives 8% of its revenue through sales of its products and solutions (built and enhanced post acquisitions). The company expects these to contribute 10%-11% for the full year. In our view, this is not enough to turn the needle on revenues.
- **Maintain Sell:** We are concerned that the company's bullish order book position is not backed by a commensurate stance operationally. We maintain Sell with a target price of Rs158, which discounts our FY11E EPS of Rs18.6 by 8.5x.

Nitin Padmanabhan

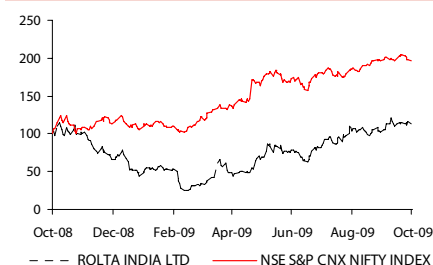
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Key Data

Bloomberg Code	RLTA IN
Reuters Code	ROLT.BO
Current Shares O/S (mn)	161.0
Diluted Shares O/S(mn)	161.0
Mkt Cap (Rsbn/USDmn)	31.3/673.6
52 Wk H / L (Rs)	206/32
Daily Vol. (3M NSE Avg.)	5,217,133
Face Value (Rs)	10

USD = Rs46.5

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Rolta India	12.5	137.6	14.5
NIFTY	0.8	43.6	93.4

Source: Bloomberg, Centrum Research
*as on 23 October 2009

Y/E June (Rsbn)	Q1 FY10	Q1FY09	YoY (%)	Q4 FY09	QoQ (%)	Q1 FY10E	Variance (%)
Net sales	3,504	3,461	1.2	3,327	5.3	3,471	0.9
Employee costs	1,299	1,299	0.0	1,343	(3.3)	1,432	(9.3)
-% of sales	37.1	37.5		40.4		41.3	
Material & Subcon	546	611	(10.6)	399	36.9	362	50.8
-% of sales	15.6	17.7		12.0		10.4	
Other expenditure	405	367	10.3	460	(12.0)	486	(16.7)
-% of sales	11.5	10.6		13.8		14.0	
Operating profit	1,254	1,185	5.9	1,125	11.5	1,191	5.3
-OPM (%)	35.8	34.2	157bp	33.8	199bp	34.3	150bp
Depreciation & amortisation	621	379		578		581	
Interest	83	0.0		57	46.6	57	46.6
EBT	550	806		490		553	
Other income	99	150		114		28	
PBT	649	956		604		581	
Exceptional item (as reported)	0.0	(614)		250		0	
Provision for tax	90	105		94		78	
-Effective tax rate %	13.9	11.0		15.6		14	
PAT	559	237		761		503	
Minority interest	2	2		2		0	
PAT (reported)	561	239		762		503	
PAT (Adjusted)	561	853	(34.2)	512	9.5	503	11.5
-NPM (%)	15.9	24.6		15.4		14.5	

Source: Company, Centrum Research

Y/E June (Rsmn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Fully DEPS	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY07	7,114	33.0	2,866	40.3	1,726	35.6	10.6	17.4	13.0	18.4	10.1
FY08	10,722	50.7	3,898	36.4	2,306	33.6	13.1	20.7	12.7	14.9	8.1
FY09	13,728	28.0	4,635	33.8	2,688	16.5	16.7	20.5	13.8	11.6	7.4
FY10E	15,514	13.0	5,825	37.5	2,773	3.2	15.8	17.9	11.8	12.3	6.3
FY11E	17,255	11.2	6,704	38.8	3,257	17.5	18.6	18.3	12.6	10.5	5.1

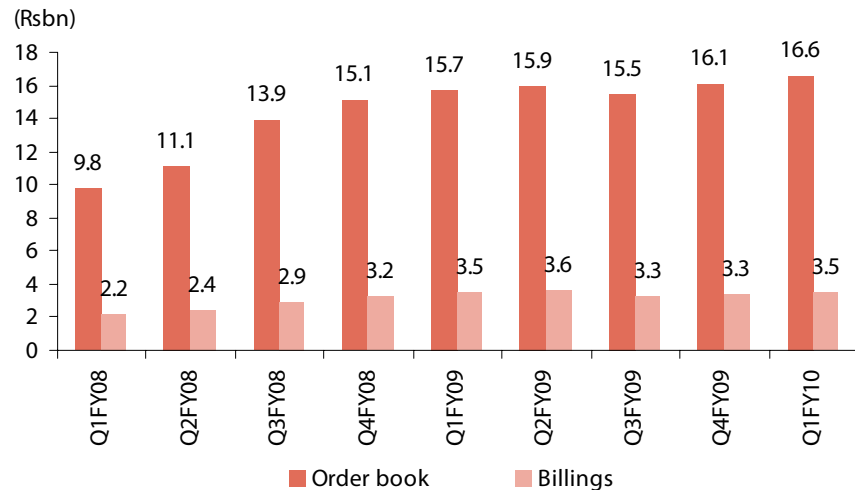
Source: Company, Centrum Research Estimates

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Steep growth outlook ...

Rolta saw its order book grow 3% QoQ to Rs16.59bn. The company is also seeing a deal pipeline of Rs50bn (to be converted), which it expects to close with a 30% hit rate. With a bullish outlook and a guidance of 12% to 15% revenue growth for the current year (would require a 6% to 8% QoQ revenue run-rate) we see disconnects in the way operations are geared towards this growth and the managements view of how they expect to achieve this growth operationally.

Exhibit 1: Second consecutive quarter of order book growth

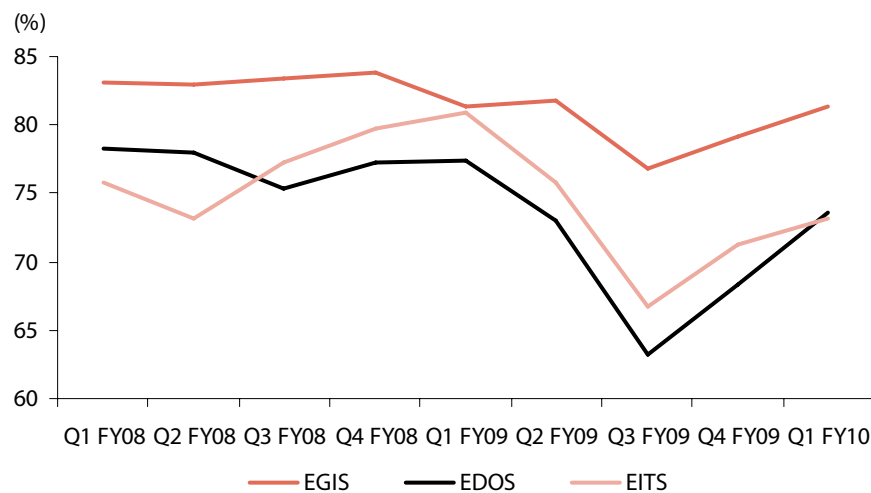


Source: Company, Centrum Research

... without commensurate change in operational stance

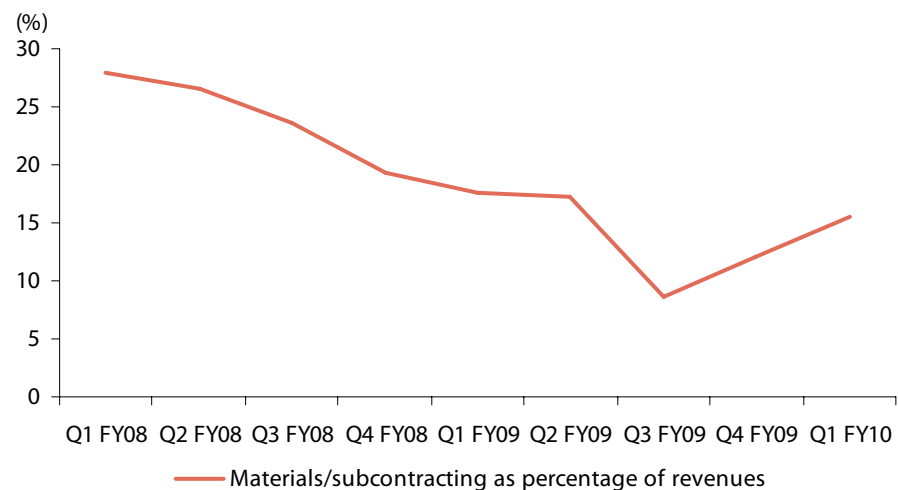
- 1) Despite utilization being close to peaks the company does not see net headcount additions more than 25 to 30. The company had a headcount of 5558 to execute an order book of Rs15.9bn in Q2FY09 with utilization at current levels. The company has seen a 14% drop in headcount since then.

Exhibit 2: Utilization close to peaks



Source: Company, Centrum Research

- 2) The company does not expect an increase in sub-contracting despite 90% of the order book being services driven.

Exhibit 3: No increase in sub-contracting from current levels

Source: Company, Centrum Research

3) No expectation of improvement in pricing either

With none of the three expected to happen, we see disconnect between a rising order book and the company's operational stance.

Belt-tightening continued in Q1 despite bullish outlook

Rolta's headcount declined 224 during Q1. Channel checks indicate that the company has discontinued allowances for working on Saturdays and onsite salaries have seen some rationalization (management confirmed the same). Hence, despite a 7% salary hike, the net salary outgo has declined. We fail to understand a conservative operational stance despite the bullish outlook. The company should have actually started gearing up for growth, in our view.

Higher product /solution-based revenue argument fails to convince

The company's stance of higher product / solutions based-revenue justifying its operational stance fails to convince. Rolta currently derives 8% of its revenues from products, and only 10% of the current order book is for products. We understand that there would be a large services component that could be an offshoot of such sales. However, the current operational stance does not justify it. The management indicated that current disclosures on billing rates do not include realizations from products and hence would not expect sharp upticks in reported billing rates. We await further data points from the management on product sales and realizations from products before we see any change in our view.

Maintain Sell

We maintain our Sell rating with a target price of Rs158, valuing the stock at 8.5x FY11E EPS of Rs18.6. We would wait for further clarification from the management before we are convinced that there has been a radical change in the company's business model to justify the current operational stance. Based on current data points, we are circumspect of such a radical change. Moreover, with product revenue contribution at only 8%, the company would still have to grow its services business at an average quarterly run rate of 7%, thereby warranting higher headcount additions or higher subcontracting. We would wait for such visibility or positive view post data points from the management before we change our view. Finally, the board's resolution to raise US\$250mn, if it were to happen even in part, would be a significant dilution at current market prices.

What can change our view?

We see only one possibility where the current operational stance would be justified and that is a marginal growth in revenue from services due to existing projects coming to an end (ie, 90% replenishment of FY09 revenues). However, this did not come up during discussions with the management. Moreover, with commentary of a Rs50bn deal pipeline and confidence on these deals closing with a 30% hit rate over the next two quarters, we remain circumspect on the current operational stance.

Exhibit 4: Current stance would mean 90% replenishment of FY09 services revenue

	FY09	FY10E
Revenues (Rsmn)	13,728	15,514
Total order book		16,590
- products (Rsmn)		1,659
- services (Rsmn)		14,931
assuming 85% execution		
- products (Rsmn)		1,410
- services (Rsmn)		12,691
FY10E including products (Rsmn)		15,138
FY10E including products and services (Rsmn)		27,829
Difference vs estimated revenues (Rsmn)		12,315

Would mean replenishing 90% of FY09 revenues

Source: Company, Centrum Research

Revising estimates marginally

We have revised our estimates marginally to factor its Q1 performance, higher-than-expected interest costs post the ECB taken last quarter and the one-off other income.

Exhibit 5: Revised estimates

(Y/E June) (Rsmn)	FY10E			FY11E		
	Earlier	Revised	Change %	Earlier	Revised	Change %
Revenues	15,386	15,514	0.8	17,118	17,255	0.8
EBIDTA	5,485	5,825	6.2	6,379	6,704	5.1
EBIDTA %	35.6	37.5	190bp	37.3	38.8	49bp
PAT	2,797	2,773	(0.9)	3,266	3,257	(0.3)
FDEPS	15.9	15.8	(0.9)	18.6	18.6	(0.3)

Source: Company, Centrum Research Estimates

Q1 FY10 review

Rolta reported 5.3% QoQ revenue growth inline with our estimate (0.9% outperformance) driven by strong performance across the Enterprise Geospatial Information Solutions - EGIS (7.2% QoQ), Enterprise Design and Operation Solutions - EDOS (2.5% QoQ) and Enterprise IT Solutions EITS – (4.8% QoQ) segments. PAT would have been lower than our estimate if not for the higher-than-expected other income at Rs99mn vs our estimate of Rs28mn. This is a one-off which includes ~Rs39mn of miscellaneous income and Rs60mn of treasury income, which implies a yield of 12% on cash. The management believes this would come down to 7%-8% in Q2. Margin was 150bp higher than our estimate on the back of negative headcount addition of 224 during the quarter and 12% QoQ decline in SG&A cost. Interest costs were higher during the quarter on higher average cost of debt post the ECB taken last quarter for the FCCB buyback.

Exhibit 6: Segmental performance matrix

Rsmn	Q2 FY08	Q3 FY08	Q4 FY08	Q1 FY09	Q2 FY09	Q3 FY09	Q4 FY09	Q1 FY10
EGIS	1,306	1,370	1,425	1,490	1,549	1,563	1,595	1,710
Growth %	8.5	4.9	4.0	4.5	4.0	0.9	2.1	7.2
EDOS	830	916	987	1,060	1,094	900	861	883
Growth %	11.4	10.4	7.8	7.4	3.2	(17.7)	(4.3)	2.5
EITS	282	598	798	912	977	858	871	913
Growth %	7.6	112.5	33.5	14.2	7.2	(12.2)	1.5	4.8

Source: Company, Centrum Research

Financials

Exhibit 7: Income Statement

Y/E June (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Net Sales	7,114	10,722	13,728	15,514	17,255
-Growth (%)	33.0	50.7	28.0	13.0	11.2
Personnel cost	1,928	3,200	5,487	5,198	5,485
% of sales	27.1	29.8	40.0	33.5	31.8
Materials & subcontracting costs	1,690	2,560	1,968	2,627	3,030
% of sales	23.8	23.9	14.3	16.9	17.6
Other expenses	630	1,064	1,638	1,865	2,036
% of sales	8.9	9.9	11.9	12.0	11.8
EBIDTA	2,866	3,898	4,635	5,825	6,704
-EBIDTA margin (%)	40.3	36.4	33.8	37.5	38.8
Depreciation	1,018	1,383	1,867	2,494	2,886
EBIT	1,848	2,515	2,768	3,332	3,818
Interest expenses	7	-	126	333	333
PBT from operations	1,841	2,515	2,642	2,999	3,485
Other non operating income	103	170	690	209	319
PBT	1,943	2,685	3,332	3,208	3,804
-PBT margin (%)	27.3	25.0	24.3	20.7	22.0
Provision for tax	217	388	402	435	541
Effective tax rate (%)	11.1	14.4	12.1	13.6	14.2
Net profit	1,726	2,297	2,930	2,773	3,263
-Growth (%)	35.6	33.1	27.6	(5.4)	17.7
-Net profit margin (%)	24.3	21.4	21.3	17.9	18.9

Source: Company, Centrum Research Estimates

Exhibit 8: Balance Sheet

Y/E June (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Share capital	801	1,609	1,609	1,609	1,609
Reserves & surplus	9,665	10,232	12,807	14,915	17,395
Total shareholder's fund	10,466	11,841	14,416	16,524	19,004
Loan fund	6,177	6,938	9,968	9,968	9,968
Deferred tax liability	346	395	395	395	395
Minority interest	-	15	15	15	15
Total capital employed	16,988	19,190	24,795	26,902	29,383
Gross block	8,283	10,583	16,153	19,353	22,353
Accumulated depreciation	3,619	4,090	5,498	7,992	10,878
Net Block	4,664	6,493	10,655	11,362	11,476
Capital WIP	1,463	1,729	2,790	2,790	2,790
Net fixed assets	6,127	8,222	13,445	14,152	14,266
Investments	976	2,816	354	354	354
Goodwill on consolidation	60	2,000	3,009	3,009	3,009
Cash and bank	6,390	2,598	1,375	3,145	5,253
Inventories	206	215	398	450	500
Debtors	3,770	5,018	5,950	6,206	6,902
Other current assets and loans	885	1,160	3,003	3,003	3,003
Total current assets and loans	11,251	8,991	10,726	12,804	15,659
Current liabilities & provisions	1,426	2,839	2,740	3,416	3,904
Net current assets	9,825	6,152	7,986	9,388	11,754
Deferred tax assets	-	-	-	-	-
Total assets	16,988	19,190	24,795	26,902	29,383

Source: Company, Centrum Research Estimates

Exhibit 9: Cash flow

Y/E June (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Cash flow from operating					
Pre tax profit	1,841	2,515	2,642	2,999	3,485
Depreciation	1,018	1,383	1,867	2,494	2,886
Interest expenses	7	-	126	333	333
Other non cash charges	100	65	-	-	-
Op. profit before WC change	2,967	3,963	4,635	5,825	6,704
Working capital adjustments	(273)	(118)	(3,058)	369	(259)
Direct tax paid	(217)	(388)	(402)	(435)	(541)
Net cash from operating	2,477	3,457	1,175	5,759	5,904
Cashflow from investing					
Capex	(2,621)	(3,477)	(7,090)	(3,200)	(3,000)
Investments	148	(1,840)	2,462	-	-
Acquisition	-	(1,940)	(1,009)	-	-
Int/dividends rcvcd/sale of securities	103	179	448	209	319
Net cash from investing	(2,371)	(7,079)	(5,189)	(2,991)	(2,681)
Cash flow from financing					
Procds from sh. cap & premium	(110)	808	-	-	-
Borrowings/(Repayments)	6,079	761	3,030	-	-
Interest paid	(7)	-	(126)	(333)	(333)
Dividend paid	(470)	(473)	(565)	(665)	(783)
Addition to reserves on amalgamation	(95)	(1,266)	452	-	-
Net cashflow from financing	5,397	(170)	2,791	(998)	(1,116)
Net cash increase/(decrease)	5,502	(3,792)	(1,223)	1,770	2,107
Cash at the start of the year	887	6,390	2,598	1,375	3,145
Cash at the end of the year	6,390	2,598	1,375	3,145	5,253
FCF	(145)	(20)	(5,915)	2,559	2,904

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E June	FY07	FY08	FY09	FY10E	FY11E
Profitability ratios (%)					
EBIDTA margin	40.3	36.4	33.8	37.5	38.8
PBIT margin	26.0	23.5	20.2	21.5	22.1
PBT margin	27.3	25.0	24.3	20.7	22.0
PAT margin	24.3	21.4	21.3	17.9	18.9
Growth (%)					
Revenue	33.0	50.7	28.0	13.0	11.2
EBIDTA	28.6	36.0	18.9	25.7	15.1
Net profit	35.6	33.1	27.6	-5.4	17.7
Return ratios (%)					
ROCE	13.0	12.7	13.8	11.8	12.6
ROIC	18.9	18.4	13.2	12.4	13.9
ROE	17.4	20.7	20.5	17.9	18.4
Turnover Ratios					
Asset turnover ratio (x)	0.4	0.6	0.6	0.6	0.6
Working capital cycle (days)	355.9	271.9	188.0	204.4	223.6
Average collection period (days)	193.4	170.8	158.2	146.0	146.0
Average payment period (days)	68.0	228.6	228.6	228.6	228.6
Per share (Rs)					
Basic EPS	21.6	14.3	18.2	17.2	20.3
Fully diluted EPS	10.6	13.1	16.7	15.8	18.6
Book value	65.0	73.6	89.6	102.7	118.1
Solvency Ratio					
Debt-equity	0.6	0.6	0.7	0.6	0.5
Interest coverage ratio	264.8	0.0	27.5	10.6	12.4
Valuation					
P/E	18.4	14.9	11.6	12.3	10.5
P/BV	3.0	2.6	2.2	1.9	1.6
EV/EBIDTA	10.1	8.1	7.4	6.3	5.1
EV/Sales	4.2	3.1	2.9	2.4	2.1
M-cap/Sales	4.4	2.9	2.3	2.0	1.8

Source: Company, Centrum Research Estimates

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